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10 **UNITED STATES DISTRICT COURT**
11 **NORTHERN DISTRICT OF CALIFORNIA**
12 **SAN FRANCISCO DIVISION**

13 PETER RUDOLPH, individually and on
14 behalf of all others similarly situated,

15 Plaintiff,

16 vs.

17 UTSTARCOM, HONG LIANG LU, YING
18 WU, MICHAEL SOPHIE, FRANCIS
19 BARTON, AND THOMAS TOY,

20 Defendants.

) Case No. 3:07-CV-04578-SI
)
)

21 **LEAD PLAINTIFF'S OPPOSITION TO**
22 **DEFENDANTS' MOTION TO DISMISS**
23 **PLAINTIFF'S AMENDED CLASS**
24 **ACTION COMPLAINT**

25 Date: April 4, 2008
26 Time: 9:00 a.m.
27)
28)

Before: Hon. Susan Illston

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INTRODUCTION

Lead Plaintiff, James R. Bartholomew, filed his Amended Class Action Complaint (the “Complaint”) on January 25, 2008. The Complaint specifically details how UTStarcom, Inc. (“UTStarcom” or the “Company”) and certain officers and directors -- Hong Liang Lu (Chief Executive Officer and Chairman of the Board), Ying Wu (Executive Vice President and Vice Chairman of the Board), Michael Sophie (Vice President of Finance and Chief Financial Officer), Francis Barton (Executive Vice President and Chief Financial Officer), and Thomas Toy (current Chairman of the Board)¹ carried out a pervasive scheme of backdating and improper accounting for stock option grants. Backdating enabled the Defendants to utilize hindsight in choosing option grant dates with favorable exercise prices. Defendants carried out this scheme in direct violation of the publicly disclosed terms of UTStarcom’s various stock option plans. When the backdating scheme became public, UTStarcom was forced to restate years of financial statements (the “Restatement”).

UTStarcom’s backdating scheme gives rise to claims under the federal securities laws because, as part of the scheme, Defendants issued a series of false and misleading statements regarding: (a) the terms of option grants; (b) the expenses associated with option grants; and (c) the strength of UTStarcom’s internal controls. Thus, Defendants, intentionally misled class members regarding, *inter alia*, the value of officer and director compensation, the Company’s compliance with Generally Accepted Accounting Principles (“GAAP”), the accuracy of the Company’s financial results (including net earnings and earnings per share), and the Company’s tax liabilities. ¶¶ 3, 9, 55-56, 64-72, 119-120.² The Complaint details precisely how the Defendants carried out their scheme and how it resulted in GAAP violations that rendered false and misleading *each and every* financial statement that UTStarcom issued during the Class Period.

¹ Lu, Wu, Sophie, Barton and Toy are collectively referred to as the “Individual Defendants.”

² References to “¶ ____” are to paragraphs of the Complaint.

1 Despite the Complaint's specifically alleged facts and the powerful inferences that can
 2 be drawn therefrom, Defendants still argue that neither scienter nor loss causation is
 3 adequately pled. Defendants' challenges not only overlook the well-pled allegations of
 4 securities fraud contained in the Complaint, but also blatantly ignore the Company's own
 5 admissions and its own public filings.

6 UTStarcom has made known in the Restatement that the Company "did not use the
 7 proper date as the measurement date," and therefore, stock options were granted with exercise
 8 prices below the fair market value of the Company's common stock. ¶ 118. Further, the
 9 Company has conceded that an *additional \$25.5 million of stock-based compensation*
 10 *expenses* should have been recognized from 1998-2005. *Id.* Moreover, the Company has
 11 admitted to backdating *no less than 57%* of all UTStarcom stock option grants from 2000
 12 through 2005. ¶ 120. The Restatement tellingly states that "[a] key finding of the
 13 Governance Committee was that there were deficiencies with the process by which stock
 14 options were granted during the period from our initial public offering in 2000 through at least
 15 2005, which resulted in accounting errors." *Id.* The Governance Committee concluded that
 16 "certain members of management bear varying degrees of responsibility for the deficiencies
 17 in the process by which options were granted." ¶ 121. These admissions cannot be
 18 disregarded or explained away on a motion to dismiss. Thus, Defendants' motion must be
 19 denied.

20 **ISSUES TO BE DECIDED (LOCAL RULE 7-4(a)(3))**

21 1. Has Plaintiff alleged fraud with sufficient particularity where he has specified
 22 each misstatement alleged to be misleading and the reason why the statement is misleading?

23 2. Has Plaintiff alleged with particularity facts that give rise to an inference of
 24 scienter that is cogent and compelling, or at least as compelling as any opposing inference one
 25 could draw from the facts?

26 3. Has Plaintiff provided Defendants with an indication of the loss and its causal
 27 connection where he has specifically pled corrective disclosures and subsequent share price
 28 drops?

4. Has Plaintiff adequately alleged that the misrepresentations were material to the shareholders in deciding to vote and that the proxy was necessary for the vote in question?

5. Has Plaintiff adequately alleged that the Defendants acted negligently by pleading particularized facts establishing Defendants' scienter?

6. Does Section 804 of Sarbanes-Oxley extend the statute of limitations for Plaintiff's § 14(a) claim for fraudulent conduct?

7. Has Plaintiff pled a cause of action under § 20(a)?

STATEMENT OF FACTS

In a five-year scheme to wrongfully increase the remuneration of the officers, directors and employees of UTStarcom³ and inflate the Company's net income by underreporting compensation expenses, the Individual Defendants intentionally manipulated stock option grants by falsely "backdating" the grants so that the options were always "in the money." The Governance Committee of UTStarcom's Board of Directors, set up to internally investigate backdating of stock options at the Company, concluded that "certain members of management bear varying degrees of responsibility for the deficiencies in the process by which options were granted [during the period from UTSI's initial public offering in 2000 through at least 2005, which resulted in accounting errors]." In fact, the Individual Defendants directly and intentionally participated in this scheme, going so far as to personally alter, and order their subordinates to alter, documentation to support the backdating of options.

When this backdating scheme finally was disclosed, the Company was forced to restate its financial statements to increase its reported expenses and decrease its net income for the last five years. UTStarcom ultimately restated its previously filed financial statements for fiscal years 2000-2006 by approximately \$25.5 million to account for these material compensation expenses. As a result of Defendants' wrongful conduct, the Company's stock

³ UTStarcom manufactures, integrates and supports IP-based, end-to-end networking and telecommunications solutions. ¶ 47.

1 price plummeted from a Class Period high of \$45.36 per share on August 21, 2003 to a low of
 2 \$3.88 per share on July 24, 2007 when the full truth about Defendants' manipulation of stock
 3 options was disclosed.

4 Throughout the Class Period, Defendants represented to the investing public that all
 5 option grants⁴ were made at the fair market value of UTStarcom stock on the date of the
 6 grant, *i.e.*, the closing price of UTStarcom common stock on the date of grant, which could
 7 not be "in-the-money," and that, indeed, UTStarcom's various stock option plans **required**
 8 option grants at the fair market value of the stock. ¶¶ 48, 52, 66, 75, 85, 95, 105. In fact,
 9 however, as the Company has now admitted, Defendants, contrary to their representations to
 10 investors, granted options using exercise prices tied to prior dates, *i.e.*, **already in-the-money**.
 11 ¶¶ 8, 9, 16, 19 113-21. In addition, in proxy statements dated April 2, 2003; August 22,
 12 2003; April 7, 2004; April 18, 2004; June 16, 2006; and June 21, 2006 (as conceded by
 13 Defendants (*see* Def. Mem. at 25)), the Defendants misrepresented officer and director
 14 compensation by stating that the exercise price of the options granted was the same as the fair
 15 market price of the stock on that day, thereby omitting to state the true value of said
 16 compensation and that option grants were in fact backdated. ¶¶ 66, 161-66.

17 This pervasive scheme extended over a period of five years and was well-known
 18 throughout the Company and by UTStarcom's accountants. ¶¶ 2, 57-60, 62, 63, 130-31, 138.
 19 Indeed, as alleged, the Individual Defendants directly participated in the backdating of
 20 options: far from Defendants' mischaracterization of the Complaint (Def. Mem. at 18-19),
 21 Confidential Witness No. 1 (CW#1), a former UTStarcom Human Resources Coordinator
 22 from 2005 through 2007 (¶ 57), **directly witnessed defendants Barton and Sophie personally**
 23 **backdating options**. ¶¶ 62, 131. CW#1, further, was **directly instructed** to backdate
 24

25
 26 ⁴ As do many companies, UTStarcom, at the direction of its Board of Directors, used stock
 27 options as a form of compensation to recruit and retain key executives and employees. ¶50.
 28 Each of the Company's stock option plans gave the Board of Directors the power to interpret
 and administer the plans, including the power to decide to whom grants would be awarded
 and at what strike price. ¶¶49-51.

1 employment documents in order to assure that options were granted “in-the-money.” ¶¶ 57-
2 58, 60. Moreover, CW#1 has stated that all paperwork associated with option grants was first
3 approved by UTStarcom’s Stock Administrator and its General Counsel. ¶ 59.

4 These backdated grants directly led to a material overstatement of UTStarcom’s net
5 income and earnings per share (“EPS”). For every quarter and fiscal year from the fiscal year
6 ended December 31, 2002 through the quarter ended March 31, 2005, UTStarcom showed
7 increasing net income and EPS. ¶¶ 74, 78, 80, 82, 84, 88, 90, 92, 94, 98. However, these
8 financial numbers were falsely buoyed by the backdating of options granted to UTStarcom
9 officers, directors and employees. Even the periods where UTStarcom showed a net loss (¶¶
10 102, 104, 110) would have been substantially worse but for Defendants’ manipulation of
11 option grants.

12 Under GAAP, if options are priced *below* a stock’s fair market value when they are
13 awarded, there is an instant gain that obligated the Company, pursuant to Accounting
14 Principles Board (“APB”) Opinion No. 25, “*Accounting for Stock Issued to Employees*”
15 (“APB 25”), to recognize that gain as a compensation expense over the vesting period of the
16 option. After June 2005, Statement of Financial Accounting Standards (“SFAS”) 123,
17 “*Accounting for Stock-Based Compensation*” (“SFAS 123”), required that the Company
18 recognize the entire value of all option grants on the grant date amortized over the vesting
19 period of the option. ¶ 8. However, in violation of GAAP, as set forth above, Defendants,
20 contrary to their representations to investors that options were granted at the market value of
21 UTStarcom stock on the grant date, actually used exercise prices tied to prior dates. By doing
22 so, Defendants understated UTStarcom’s compensation expenses which consequently -- and
23 in violation of Lu and Sophie’s Sarbanes-Oxley Act certifications -- propped up the
24 Company’s net income (loss) and earnings (loss) per share, which then led to the artificial
25 inflation of UTStarcom’s stock price, throughout the Class Period.

26 Not only did the backdating of options cause UTStarcom to violate GAAP, it also
27 caused the Company to understate its tax liabilities. ¶¶ 67-71. Section 421 of the Internal
28 Revenue Code (“IRC”) allows special treatment for stock options *not granted at a discount*.

1 Under IRC § 422, such options are considered Incentive Stock Options (“ISO”), and, when
2 the grantee exercises the option, any gain is not taxed as ordinary income, and, therefore, the
3 Company is not responsible for any withholding associated with that gain. ¶¶ 68-70.

4 However, if the option granted does not qualify as an ISO, it is considered a Non-Statutory
5 Option (“NSO”), and the Company incurs withholding obligations on the employee’s gain.
6 *Id.* When Defendants instituted their scheme to backdate options, they treated the options as
7 ISOs, with the attendant benefit of eliminating the withholding obligation, when they should
8 have treated the options as NSOs. ¶ 71. This had the effect of understating the Company’s
9 tax liabilities. *Id.*

10 It is important to note that the Individual Defendants directly and personally profited
11 from the backdating of options. They were granted over 800,000 total options in 2002 and
12 2003, and the Company has confirmed that the vast majority of options received by
13 employees during that time period were backdated. ¶¶ 9, 19, 118-21, 133-35. As a result,
14 they wrongfully reaped proceeds of over \$38.8 million from stock sales during the Class
15 Period. ¶¶ 33-37.

16 In the wake of the growing options backdating scandals of late 2006 and early 2007,
17 on November 7, 2006, UTStarcom announced that it had begun a voluntary review of its
18 historical equity award grant practices. ¶¶ 11, 113. On this news, UTStarcom’s stock price
19 fell 9% from \$10.23 per share on November 7, 2007 to a closing price of \$9.32 per share on
20 November 9, 2006. ¶ 113. On February 1, 2007, with no final results of the Company
21 inquiry in hand, the Company updated the investigation, announcing that incorrect
22 measurement dates for certain stock option grants were used; the investing community could
23 no longer rely on UTStarcom’s financial statements for each of the three fiscal years in the
24 period ended December 31, 2005 and financial statements for fiscal years prior to fiscal 2003;
25 and that the Company expected to record additional compensation charges of approximately \$
26 50 million . ¶ 115. The Company’s stock price dipped to \$8.90 per share on February 2,
27 2007.

1 Finally, on July 24, 2007, the full truth was disclosed. As a result of Defendants'
2 manipulation of option grants, a restatement of Company financials of approximately \$28
3 million in fact would be necessary:

4 . . . [I]n certain instances all actions that establish a measurement date under
5 the requirements of Accounting Principles Board No. 25, Accounting for Stock
6 Issued to Employees, had not occurred at the grant date, which had been used
7 as the measurement date in accounting for Company stock option grants. A
8 later date, when all such actions had taken place, should have been used as the
9 measurement date for these stock options. The Audit Committee . . . then
determined, in consultation with and on the recommendation of the Company's
management, the effect of using incorrect measurement dates would require
the Company to record material additional stock-based compensation charges
in its previously issued financial statements.

10 The Company therefore announced its previously issued financial statements
11 for the years 2000 through 2006, including interim periods within these fiscal
12 years, should no longer be relied upon.

13 The Company has now determined that the amount of the non-cash restatement
will be approximately \$28 million over the years 2000 through 2006.

14 ¶ 116. As a result of this disclosure, UTStarcom's stock price dropped by 22%, from \$4.73
15 per share on July 23, 2007 to \$3.70 per share on July 25, 2007. ¶ 117.

16 On October 10, 2007, upon issuing its Form 10-Q for the quarter ending on September
17 30, 2007 (the "2007 3rd Quarter 10-Q"), the Company announced that its Governance
18 Committee found that 17.9 million stock options of the 28.8 million options granted during
19 2000 through 2005 -- or 62% -- had incorrect measurement dates. ¶¶ 9, 120. Out of the 17.9
20 million option grants that used the wrong date, 10.3 million used exercise prices below
21 UTStarcom's closing price on the date of the grant, resulting in an increase in compensation-
22 related expenses of over \$32 million, including \$6.1 million of additional non-cash stock-
23 based compensation expense from 2.0 million options that were granted to officers and
24 directors. ¶¶ 9, 120. The Company further conceded that it was liable for an additional \$1.5
25 million in additional taxes as a result of its failure to properly date option grants and that it
26 "has assumed responsibility for all additional payroll taxes plus related penalties and interest
27 arising from the restatement of stock-based compensation, including amounts otherwise
28

1 payable by stock option recipients, and the Company's restated financial statements include a
2 \$1.5 million accrual for this estimated expense." ¶¶ 72, 120.

3 As a result of the uncovering by the Company's internal investigation of Defendants'
4 wrongful backdating of options, UTStarcom and the Individual Defendants acted to "correct"
5 their wrongful behavior: Lu, Wu, Barton, Huang, Toy, along with three other officers and
6 directors, elected to amend any of their previously granted stock options that might in the
7 future be determined to be discounted stock options. ¶¶ 15, 129. On June 6, 2007, in the
8 midst of the investigation, the Company announced that it was terminating its employment
9 relationship defendant Wu. ¶¶ 18, 129.

10 ARGUMENT

11 I. STANDARDS OF LAW ON A MOTION TO DISMISS

12 When considering a motion to dismiss, a court must accept the allegations as true and
13 construe them in the light most favorable to the plaintiffs. *Tellabs, Inc. v. Makor Issues &*
14 *Rights, Ltd.*, 127 S. Ct. 2499, 2509 n.4 (2007); *Shurkin v. Golden State Vintners Inc.*, 471 F.
15 Supp.2d 998, 1011 (N.D. Cal. 2006) (citing *Schwarz v. U.S.*, 234 F.3d 428, 435 (9th Cir.
16 2001)). These well-settled standards apply with equal force to cases brought under the Private
17 Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 ("PSLRA").⁵

18 The basic purposes of the securities laws mandate that reasonable inferences suffice
19 and that evidence need not be pleaded. *No. 84 Employer-Teamster Joint Council Pension*
20 *Trust-Fund v. Am. West Holding Corp.*, 320 F.3d 920, 946 (9th Cir. 2003); *see also In re*
21 *Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 1018 (S.D. Cal. 2005) ("Courts must be
22 careful not to set the [post-PSLRA pleading] hurdles so high that even meritorious actions
23 cannot survive a motion to dismiss. Such a regime would defeat the remedial goals of the

24
25 ⁵ See, e.g., *In re Daou Sys. Inc. Sec. Litig.*, 411 F.3d 1006, 1013 (9th Cir. 2005) ("We accept
26 the plaintiffs' allegations as true and construe them in the light most favorable to plaintiffs.")
27 (citation omitted), *cert. denied*, 546 U.S. 1172 (2006); *Nursing Home Pension Fund, Local*
28 *144 v. Oracle Corp.*, 380 F.3d 1226, 1229 (9th Cir. 2004) ("The general rule for 12(b)(6)
motions is that allegations of material fact made in the complaint should be taken as true and
construed in the light most favorable to the plaintiff).

1 federal securities laws.”) (citation omitted). Moreover, a complaint must be construed as a
 2 whole on a motion to dismiss. *See Tellabs*, 127 S. Ct. at 2509 (“courts must consider the
 3 complaint in its entirety”); *see also Am. West*, 320 F.3d at 945 (reversing a district court
 4 dismissal because “although...some of Plaintiffs’ allegations are individually lacking...the
 5 allegations in their totality are sufficient to meet the stringent pleading standard set forth in
 6 the PSLRA.”).

7 **II. LEAD PLAINTIFF HAS STATED A CLAIM FOR SECURITIES FRAUD**
 8 **UNDER SECTION 10(b) AND RULE 10b-5**

9 **A. Lead Plaintiff has Alleged the Fraud With Sufficient Particularity**

10 Lead Plaintiff has alleged with minute detail the precise false and misleading
 11 statements and omissions made by Defendants throughout the Class Period, and the reasons
 12 why these statements or omissions were false and misleading. The false and misleading
 13 statements alleged include but are not limited to the following:

- 14 • that the Company had granted stock options in accordance with its 1997 Stock Option
 15 Plan and 2001 Director Plan, and that the exercise prices of the options that were
 16 granted under these plans were not less than the fair market value of UTStarcom’s
 17 common stock on the grant dates; ¶¶ 52, 53, 75, 85, 95, 105
- 18 • all statements regarding the amount of UTStarcom’s net income and EPS made from
 19 February 21, 2003 through August 9, 2006 in the Company’s Annual Reports (Form
 20 10-K) and Quarterly Reports (Form 10-Q); ¶¶ 74, 77-84, 87-94, 97-104, 107-111
- 21 • all statements regarding the amount of UTStarcom’s expenses made from February
 22 21, 2003 through August 9, 2006; ¶¶ 74, 77-84, 87-94, 97-104, 107-111
- 23 • that the stock options granted to Lu, Wu, Sophie, Barton and Toy had exercise prices
 24 not less than the fair market value of UTStarcom’s common stock on the grant dates;
 25 ¶¶ 52, 53, 66
- 26 • that UTStarcom’s financial statements were prepared in accordance with GAAP; ¶¶
 27 118-120.

- 1 • that UTStarcom properly accounted for stock option grants pursuant to APB 25; ¶¶
- 2 74-111
- 3 • that UTStarcom maintained appropriate internal disclosure controls and procedures;
- 4 ¶¶ 118-120
- 5 • that UTStarcom's SEC filings were free of material misstatements or omissions; ¶¶
- 6 76, 86, 96, 106
- 7 • that UTStarcom's SEC filings complied with the requirements of the securities laws
- 8 and fairly presented the financial condition and results of the Company; ¶¶ 76, 86,
- 9 96, 106

10 This is all that is required. *See In re Secure Computing Corp. Sec. Litig.*, 184 F.
 11 Supp.2d 980, 985 (N.D. Cal. 2001) (stating that the PSLRA requires that the complaint
 12 specify each statement alleged to have been misleading that the reason of reasons why the
 13 statement is misleading); *see also In re U.S. Aggregates, Inc. Sec. Litig.*, 235 F.Supp.2d 1063,
 14 1069 (N.D. Cal. 2002).

15 Moreover, given the fact that Defendants have restated the Company's financials by
 16 **\$25.5 million** for a multi-year period the materiality of these misrepresentations is not subject
 17 to dispute.⁶ The materiality of these facts is further corroborated by the UTStarcom share
 18 price drops in reaction to the disclosures of Defendants' backdating.⁷

20 ⁶ *See In re Zoran Corp. Derivative Litig.*, 511 F. Supp.3d, 984, 1011 (N.D. Cal. 2007)
 21 (finding materiality adequately pled where plaintiff alleged that Zoran had to restate its
 22 financials and recognize a charge of twelve to fifteen million dollars in compensation
 23 expenses); *In re Ramp Networks, Inc. Sec.*, 201 F. Supp.2d 1051, 1066 (N.D. Cal. 2002)
 24 (finding that a restatement provides evidence that statements made about revenue and
 25 accounting principles were false when coupled with specific allegations about practices that
 violate GAAP); *In re Cylink Sec. Litig.*, 178 F. Supp.2d 1077, 1084 (N.D. Cal. 2001) (stating
 that "the mere fact that...statements were restated at all" is sufficient to establish falsity at the
 pleading stage).

26 ⁷ *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425(3d Cir. 1997) (holding
 27 that when a stock is traded in an efficient market, the materiality of disclosed information may
 28 be measured post hoc by looking to the movement in the period immediately following the
 disclosure); *In re National Golf Properties, Inc.*, No. 02-1383, 2003 WL 23018761, *5 (C.D.

1 **B. Lead Plaintiff has Alleged Facts Giving Rise to a Strong Inference of**
 2 **Scienter**

3 Lead Plaintiff's allegations, when properly considered in their entirety, give rise to a
 4 strong inference that Defendants acted with the requisite scienter throughout the Class Period.
 5 In addressing the proper standard to be applied in considering whether a plaintiff's allegations
 6 give rise to such an inference, the Supreme Court has held that:

7 [C]ourts must consider the complaint in its entirety, as well as other sources
 8 courts ordinarily examine when ruling on Rule 12(b)(6) motions to
 9 dismiss...The inquiry, as several Courts of Appeals have recognized, is
 10 whether *all* of the facts alleged, taken collectively, give rise to a strong
 11 inference of scienter, not whether any individual allegation scrutinized in
 12 isolation, meets that standard.

13 *Tellabs*, 127 S.Ct. at 2509 (2007) (citing *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir.
 14 2002)). The alleged facts must give rise to an inference of scienter that is "cogent" and
 15 "compelling," in other words "at least as compelling as any opposing inference one could
 16 draw from the facts alleged." *Id.*

17 Lead Plaintiff's Complaint satisfies this standard, setting forth particularized
 18 allegations regarding UTStarcom's pervasive backdating scheme and misrepresentations that
 19 give rise to a strong inference of scienter as to each Defendant. This inference is not only
 20 "cogent" and "compelling" – *it is the only logical inference to be drawn*. Defendants fail to
 21 suggest any facts that give rise to an inference of plausible non-fraudulent intent, instead
 22 taking each of Lead Plaintiff's allegations one by one, and claiming that each one, viewed in
 23 isolation, is insufficient. This tactic is flatly inconsistent with the *Tellabs* standard, and
 24 should not be countenanced. Instead, the scienter analysis requires courts to consider all
 25 circumstances and all allegations, *in toto*. When taken as a whole (as they must be), the
 26 scienter facts pled in the Complaint paint an overwhelming and detailed portrait of
 27 Defendants' scienter.

28 Cal. Mar. 19, 2003) (finding materiality had been alleged at the pleading stage where drop in
 stock price followed a restatement of financials).

1 The magnitude, duration and materiality of UTStarcom's admitted GAAP violations
 2 and the Restatement, combined with the Individual Defendants' knowledge of the faulty
 3 accounting practices and direct involvement in the stock option granting process, and the
 4 information provided by the confidential witnesses all combine to provide a cogent and
 5 compelling inference of scienter. As such Defendants' Motion to Dismiss should be denied.

6 **1. The Pervasive and Systematic Accounting Violations Admitted by**
 7 **UTStarcom In Its Restatement Contribute to a Strong Inference of**
 8 **Scienter**

9 UTStarcom argues that "a restatement, by itself, indicates only that a company's
 10 financials were incorrect, not the existence of an attempt to defraud." Def. Mem. at 10. As
 11 stated above, UTStarcom's attempt to address this allegation in isolation is improper under
 12 *Tellabs*. It is clear that the pervasive and systematic accounting violations detailed in the
 13 Restatement contribute to a strong inference of scienter. Further, Defendants' contention that
 14 the Company's Governance Committee found that "none of the current or former employees
 15 or directors of the Company engaged in intentional wrongdoing" is unavailing. Def. Mem. at
 16 11. It comes as no surprise that the Company's internal investigative committee did not admit
 17 that its own officers and directors had engaged in fraud.

18 UTStarcom's Restatement admits that every financial statement and accompanying
 19 press release issued by the Company and signed by Lu, Wu, Sophie, Toy and Barton during
 20 the Class Period and prior to the Class Period were materially false and misleading when
 21 made. ¶ 118-121. Indeed the Restatement details that Defendants backdated no fewer than
 22 10.9 million options or 57% of all option grants during the period in question. *Id.*

23 The pervasive, long term, repeated financial misstatements which gave rise to
 24 UTStarcom's Restatement and admitted accounting violations thus contribute mightily to a
 25 strong inference that Defendants acted with intent or deliberate recklessness.⁸ Moreover,

26 ⁸ See *Cylink*, 178 F. Supp.2d at 1084 (finding that the mere fact that the financials had to be
 27 restated supports an inference of scienter); see also *In re Cornerstone Propane Partners, L.P.*,
 28 355 F. Supp. 2d 1069, 1091 (N.D. Cal. 2005)(holding that allegations of GAAP violations
 provide support for plaintiffs' allegations of scienter); see also *In re Adaptive Broadband Sec.*

1 “when significant GAAP violations are described with particularity in the complaint, they
 2 may provide powerful indirect evidence of scienter. After all, books do not cook themselves.”
 3 *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp.2d 1248, 1273 (N.D. Cal. 2000).

4 This is particularly true in cases of options backdating, because options simply do not
 5 date themselves. Rather, it requires a specific act of will on the part of the officers and
 6 directors of a corporation to assign a date to the issuance of an option. Further, it requires a
 7 conscious, intentional act to date such options on a day other than that in which they are
 8 actually being authorized. *See In re CNET Networks, Inc.*, 483 F. Supp.2d 947, 956 (N.D.
 9 Cal. 2007). Thus, and to paraphrase from *McKesson*, just as “books do not cook themselves,”
 10 ***options do not (indeed, cannot) backdate themselves.*** Indeed, statistical analysis indicates
 11 that the cumulative share price drops prior to UTStarcom option grants and cumulative gains
 12 in share price following the dates of option grants provides strong evidence that these dates
 13 were intentionally selected with the benefit of hindsight to enrich the grantees. ¶ 63. This
 14 was no coincidence.

15 Significantly, UTStarcom does not deny that its historical financial statements were in
 16 error as a result of a failure to properly account for stock option grants. Indeed, Defendants
 17 have admitted that no fewer than 10.3 million options granted during the five year period
 18 were misdated. ¶ 120. Therefore, neither the GAAP violations, the materiality of those
 19 violations, nor the falsity of the financial statements is in dispute. ¶ 118-121. The magnitude,
 20 pervasiveness and duration of these admitted GAAP violations contributes compellingly to
 21 the strong inference of scienter.⁹

22
 23
 24 *Litig.*, No. 01-1092, 2002 WL 989478, at *14 (N.D. Cal. April 2, 2002) (finding that a
 25 restatement is sufficient to support a scienter inference when coupled with strong evidence of
 deliberately reckless accounting).

26 ⁹ The Ninth Circuit unequivocally has held that allegations of widespread or systematic
 27 GAAP violations such as those stated in the Complaint support a strong inference of scienter.
 28 *Daou*, 411 F.2d at 1018, 1020; *see also Adaptive Broadband*, 2002 U.S. Dist. LEXIS 5887, at
 ** 39, 42 (“While it is true that conclusory allegations of GAAP violations *standing alone*

2. Lead Plaintiff's Confidential Witness Allegations Contribute to a Strong Inference of Scierter

The Complaint contains allegations based upon direct, eye-witness observations of confidential witnesses who have related to Plaintiff's counsel their experiences in connection with UTStarcom's backdating scheme. These confidential witnesses disclosed that options backdating was a common practice at the Company and that at various times, CW#1 was directed to purposefully and intentionally alter documents for this purpose. ¶ 57-62.

In light of the PSLRA's heightened pleading standard, plaintiffs relying on confidential witnesses to raise an inference of scierter must meet certain requirements. First, plaintiffs must describe each confidential witness "with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Daou*, 411 F.3d at 1015 (quoting *Nursing Home*, 380 F.3d at 1233) (internal quotation marks omitted). If a plaintiff adequately describes a confidential witness, the court then proceeds to a determination of the witness's reliability by evaluating "the level of detail provided by the confidential sources, the corroborative nature of the other facts alleged (including from other sources), the coherence and plausibility of the allegations, the number of sources [and] the reliability of the sources" *Id.* (quoting *In re Cabletron Sys., Inc.*, 311 F.3d 11, 29-30 (1st Cir.2002)).

Here, the Complaint clearly alleges sufficient information to support the probability that the respective witnesses possessed the information alleged. ¶ 57-62. For example, Lead Plaintiff indicates that CW#1 was the Human Resources Coordinator at the Company from 2005 through 2007. ¶ 57. The complaint further details CW#1's first hand account of the mechanics of stock option grant reports, where the Company maintained this information,¹⁰

cannot be used to prove intentional or reckless misconduct, if pled in detail and read in context, GAAP violations may support an inference of scierter.")

¹⁰ CW#1 further described in detail how the paper trail of the backdated options was kept. ¶ 59. After approval by the Board of Directors, the backdated options would then be approved by the Company's General Counsel and Stock Administrator. *Id.* According to CW#1, the Company maintained all information relating to the granting of the backdated options within

1 how the witness was involved in the backdating process and the involvement of outside
 2 auditors in the backdating scheme.¹¹ ¶ 57-62. These details are more than sufficient to allow
 3 the Court to credit these allegations.

4 Indeed, the witnesses' detailed accounts of the backdating scheme as it operated
 5 within UTStarcom are nothing short of damning. CW#1 disclosed that during her time at the
 6 Company, UTStarcom actively backdated its stock option grants to senior executives to assure
 7 that they would receive the highest possible margins in the exercise and sales of their options.
 8 ¶ 57. She revealed that she was directed to purposefully and intentionally alter documents for
 9 this purpose. *Id.* In fact, CW#1 stated that she actually witnessed Defendants Barton and
 10 Sophie, at different times, fabricating and altering documents for the purpose of backdating
 11 options. Further, she indicated that the backdating scheme was a commonly discussed
 12 practice within the Company. *Id.* Confidential Witness #2, an Administrative Support
 13 Representative, corroborated and confirmed this statement. *Id.*

14 Fact-specific, detailed, eye-witness accounts of Defendants' active, intentional role in
 15 a fraud obviously suffices at the pleading stage to give rise to a strong inference of scienter –
 16 particularly when pled in conjunction with other indicia of fraudulent intent. *See McKesson*,
 17 126 F. Supp.2d at 1271. That is exactly what the Complaint pleads.

18 **3. The Sarbanes-Oxley Certifications Contribute to a Strong Inference of** 19 **Scienter**

20 Throughout the Class Period, the Individual Defendants certified the Company's
 21 financial reports. Indeed, pursuant to these certifications, the Individual Defendants have
 22 admitted reviewing and being familiar with the Company's financial reports. ¶¶76, 86, 96,
 23 106, 123.

24
 25 an ADP HRIS system until September 2005 when they transitioned to an Oracle based
 26 system. *Id.*

27 ¹¹ During her interview, CW#1 recalled that the Company's pre-audit accountants, Deloitte &
 28 Touche, frequently requested that the witness backdate various employment papers in order to
 bring the Company into apparent compliance for its audits by PriceWaterhouseCoopers. ¶
 58.

1 These certifications, signed pursuant to § 906 of Sarbanes-Oxley, can give rise to a
 2 strong inference of scienter. *In re Lattice Semiconductor Corp. Sec. Litig.*, No. 04-1255, 2006
 3 U.S. Dist. LEXIS 262, at **45-50 (D. Or. Jan. 3, 2006). Although Sarbanes-Oxley does not
 4 create a scheme of strict liability, the statements contained in the certifications themselves can
 5 constitute evidence of actual knowledge or deliberate recklessness on the part of the certifying
 6 officers. *Id.* This is so because the certifications create a presumption that the signators were
 7 familiar with, and responsible for, the preparation of the financial statements and certified
 8 their veracity. *Id.* Here, the certifications contribute to a strong inference of scienter because
 9 there is no dispute regarding the falsity of UTStarcom's certified financial statements. ¶¶
 10 118-21.

11 **4. Lead Plaintiff Adequately Alleges the Individual Defendants'** 12 **Involvement in the Stock Option Granting Process**

13 Lead Plaintiff has pled "specific contemporaneous conditions known to the defendants
 14 that would strongly suggest that the defendants understood" their statements to be false. *See*
 15 *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079 (9th Cir. 2002). Lead Plaintiff's complaint
 16 specifically alleges that the Officer Defendants, Lu, Wu, Sophie and Barton, as executives and
 17 members of the Board of Directors, personally authorized and approved the backdated stock
 18 option grants at issue. ¶ 33-36. Further, the Complaint alleges that Defendant Toy, as a
 19 member of the Audit and Compensation Committees, enabled the stock option backdating
 20 scheme to succeed. ¶ 37. Lead Plaintiff has thus clearly specified the roles that the Individual
 21 Defendants played in authorizing and approving backdated stock option grants.¹² Plainly,
 22 allegations of the Defendants direct participation in this fraud contribute significantly to a
 23 strong inference of scienter.

24
 25
 26 ¹² Each of the Company's stock option plans gave the Board of Directors or any of its
 27 Committees the full power to interpret and administer the plans. ¶ 50. Thus, the Board and, in
 28 particular, the Compensation Committee, were intimately involved in the process of granting
 (and, necessarily, dating) these options.

1 **5. The Individual Defendants’ Insider Trades Contribute to a Strong**
 2 **Inference of Scienter**

3 The Individual Defendants directly and personally profited from the backdating of
 4 options: they were granted over 800,000 total options in 2002 and 2003, and the Company has
 5 confirmed that the vast majority of options received by employees during that time period
 6 were backdated. ¶¶ 9, 19, 118-21, 133-35. As a result, they wrongfully reaped proceeds of
 over \$38.8 million from their stock sales during the Class Period. ¶¶ 33-37.

7 “Unusual trading or trading at suspicious times or in suspicious amounts by corporate
 8 insiders has long been recognized as probative of scienter.” *Daou*, 411 F.3d at 1022. These
 9 massive insider sales, stemming from the exercise of backdated options and taking place
 10 while the Company was materially understating compensation expenses and overstating net
 11 income, certainly provide even more credence to a cogent, strongly compelling inference of
 12 Defendants’ scienter.¹³

13 **III. LEAD PLAINTIFF HAS ADEQUATELY PLED LOSS CAUSATION**

14 The Supreme Court has held that pleading loss causation is governed by the notice
 15 pleading standard of Federal Rule of Civil Procedure 8(a)(2), which requires only a “short and
 16 plain statement of the claim showing that the pleader is entitled to relief.” *Dura Pharm., Inc.*
 17 *v. Broudo*, 544 U.S. 336, 346 (2005). Thus, a plaintiff must provide a short and plain
 18 statement giving “notice of what the relevant economic loss might be or what the causal
 19 connection might be between” the loss and the misrepresentation. *Id.* at 347. However, a
 20 plaintiff need only “provide a defendants with *some indication* of the loss and the causal
 21 connection that the plaintiff has in mind.” *Id.* (emphasis added).

22 Under *Dura*, loss causation is sufficiently pled when the complaint alleges a causal
 23 link between the disclosure of previously undisclosed information and the decline in stock
 24 price. *Id.* at 336. In the Ninth Circuit, a complaint satisfies the loss causation pleading
 25

26 ¹³ See *Cornerstone*, 355 F. Supp. 2d at 1095 n.7 (finding that insider sales can form a basis for
 27 inferring scienter where the sales were unusual or suspicious); see also *In re Silicon Graphic*
 28 *Sec. Litig.*, 183 F.3d 970, 986 (9th Cir. 1999) (stating that “unusual” or “suspicious” stock
 sales by insiders can constitute circumstantial evidence of scienter).

1 requirement when it alleges “a causal connection between the deceptive acts that form the
 2 basis for the claim of securities fraud and the injury suffered by the plaintiff.” *Daou*, 411
 3 F.3d at 1025. This causal connection is established where, as here, the revelation of the true
 4 facts which had been previously omitted or misrepresented causes the stock price to fall. *See*
 5 *id.*; *see also Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., Inc.*, 411 F.
 6 Supp.2d 1172, 1177 (N.D. Cal. 2005) (finding loss causation adequately alleged where a drop
 7 in stock price followed a corrective disclosure). Further, under *Daou*, in order to show loss
 8 causation, a plaintiff need not show that a misrepresentation was the sole reason for the
 9 investment’s decline. 411 F.3d at 1025.

10 Lead Plaintiff’s specific loss causation allegations meet the pleading requirements. In
 11 particular, the Complaint alleges: (a) Plaintiff purchased UTStarcom stock during the Class
 12 Period, ¶ 31; (b) the stock prices during the Class Period were artificially inflated due to
 13 Defendants’ undisclosed options backdating scheme, ¶¶ 3, 4, 45, 142, 145; (c) when the truth
 14 about Defendants’ backdating and its implications became known by the market,
 15 UTStarcom’s stock price declined, ¶¶ 3-4, 142-148; and (d) the disclosure of Defendants’
 16 backdating scheme was a cause of the stock price declines, ¶¶ 3-4, 142-148. Lead Plaintiff
 17 details facts regarding the misstatements and omissions and how the market negatively
 18 reacted to revelations of the fraud. These allegations satisfy the loss causation pleading
 19 requirements.

20 Simply stated, and as more fully discussed below, the Complaint directly pleads that
 21 information revealed to investors the truth about the previously undisclosed backdating and
 22 proximately caused the fall in UTStarcom’s stock price on November 7, 2006 and July 24,
 23 2007. As such, Lead Plaintiff has properly pled loss causation for each disclosure detailed in
 24 the Complaint.¹⁴

25
 26 ¹⁴ *See Immune Response*, 375 F. Supp.2d at 1025 (finding that allegations that the corrective
 27 disclosures caused the drop in stock price satisfies *Dura*); *see also Plumbers & Pipe*, 411 F.
 28 Supp. 2d at 1177-78 (finding stock declines following partial disclosures sufficient to plead
 loss causation under *Dura*); *In re Omnivision Tech.*, No. 04-2297, 2005 U.S. Dist. LEXIS

A. The November 7, 2006 Revelation was a Corrective Disclosure and Caused a Loss to Lead Plaintiff and the Class.

Lead Plaintiff adequately pled loss causation with respect to the November 7, 2006 revelation of previously undisclosed bad news regarding the Company's internal investigation into its stock option grant practices. On that date, after the close of trading, the Company filed an SEC report on Form 8-K disclosing that the Company had commenced a review of its historic equity award grant practices. ¶ 147. The Form 8-K indicated that the Company had informed the SEC about the commencement of the review. *Id.* The Company claimed uncertainty in regard to the review's effect on prior financial statements, and admitted that this stock option investigation would interfere with UTStarcom's ability to timely file its SEC reports. ¶¶ 11-12, 147. The next trading day, UTStarcom's stock dropped 9% as a result of this news. *Id.* Thus, the Amended Complaint alleges: (1) the disclosure of previously concealed negative facts related to the backdating scheme; and (2) an immediate drop in UTStarcom's stock price due to the disclosure of this new information. Plainly, Lead Plaintiff has properly and sufficiently alleged loss causation in connection with this revelation. *See Dura*, 544 U.S. at 347; *see also Daou*, 411 F.3d at 1025; *Cisco*, 411 F. Supp.2d at 1177-78.

Nevertheless, Defendants argue that the November 7th revelations were not a "corrective disclosure". Def. Mem. at 6-7. This is ludicrous. Defendants were informing the market (and the SEC) of an internal investigation relating to options backdating that might (and eventually would) cause the Company to restate its financial reports. The market was obviously aware that companies do not announce such investigations, possible restatements and delays in future financial reports and filings unless there is substantial cause for concern – and the drop in the share price reflected this fact. This was, plainly, a corrective disclosure under *Daou*, which merely requires the allegations to provide "some indication that the drop in . . . stock price was causally related to . . . financial misstatements." *Daou*, 411 F.3d at 1026.

16009, at **18-19 (N.D. Cal. July 29, 2005)(alleging that plaintiffs suffered damages when revelation of the true facts caused a decline in the value of their investments satisfies *Dura*).

1 Defendants' reliance on *Weiss v. Amkor Tech., Inc.*, 527 F. Supp. 2d 938 (D. Ariz.
 2 2007), is unavailing. There, the plaintiff failed to sufficiently plead loss causation because
 3 Amkor's stock price went up, not down, after corrective disclosures were issued regarding
 4 options backdating. *Id.* at 945-46. In this case, Lead Plaintiff alleges that disclosures
 5 regarding possible and actual backdating at UTStarcom caused temporally proximate declines
 6 in UTStarcom's stock price.¹⁵ Nothing more is required.

7 **B. Defendants Ask the Court to Draw Impermissible Inferences Concerning the**
 8 **July 24, 2007 Disclosure**

9 On July 24, 2007, at the close of trading, Defendants revealed for the first time that the
 10 Company would be definitively forced to restate its financial results by over \$28 million due
 11 to the backdating of employee stock options. ¶ 148. The next day, following this
 12 announcement, the Company's share price dropped 22%. ¶ 148. Allegations such as this
 13 more than satisfy the loss causation pleading requirements of *Dura* and *Daou*.

14 Defendants' argument that this news was positive is meritless. It is inconceivable that
 15 the need to restate \$28 million can be considered "good news," as Defendants would like to
 16 characterize it. Rather, this was a revelation that an internal investigation had definitively
 17 found that the Company had backdated options, and had consequently under-reported
 18 compensation expenses and overstated income by \$28 million over a period of several years.
 19 The notion that the market would react to this with anything other than a punitive share price
 20 drop is unsupportable.

21 Moreover, to the extent that Defendants improperly contend that other disclosures on
 22 July 24, 2007 caused or contributed to UTStarcom's share price drop, they ignore the legal
 23 reality that, at this phase of the litigation, a plaintiff is not required to show "that a
 24 misrepresentation was the *sole* reason for the investment's decline in value" in order to
 25 establish loss causation. *Daou*, 411 F.3d at 1025 (quoting *Robbins v. Koger Props., Inc.*, 116

26 ¹⁵ *Amkor* is also inapposite as the court ruled there that plaintiffs could not allege loss
 27 causation based on an investigation of the stock option grants because the real discussion in
 28 the press release was the second quarter financial results. *Id.* at 946. Defendants' November
 6, 2007 had no discussion other than the stock option grant review.

1 F.3d 1441, 1447 n.5 (11th Cir. 1997) (emphasis added). Nevertheless, Defendants ask the
 2 Court to decide improperly (or at least prematurely) this precise issue of fact, contending that
 3 other disclosures on July 24, 2007 were the cause of the Company's share price drop. This is
 4 not an appropriate question for this phase of the litigation.¹⁶

5 **IV. LEAD PLAINTIFF HAS STATED A CLAIM FOR PROXY FRAUD**

6 Lead Plaintiff has more than adequately alleged each element of a §14(a) claim – that
 7 is, “that: (1) defendants made a material misrepresentation or omission in a proxy statement;
 8 (2) with the requisite state of mind; and (3) that the proxy statement was the transaction cause
 9 of harm of which plaintiff complains.” *Zoran.*, 2007 U.S. Dist. LEXIS 43402, *63 (N.D.
 10 Cal. June 5, 2007) (citing *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970)). The
 11 Complaint specifically identifies false and misleading statements contained in the proxy
 12 statements and adequately alleges that the Defendants' misrepresentations caused the injury
 13 suffered by Lead Plaintiff and the Class. As such the Motion must be denied on this count.

14 **A. Lead Plaintiff has Pled Misrepresentations in the Proxies**

15 Defendants claim that Lead Plaintiff's complaint “does not quote a single statement
 16 from any of the Company's proxies that are alleged to be misleading.” Def. Br. at 21. This
 17 contention is utterly (and obviously) false. The complaint specifically alleges that
 18 UTStarcom's annual proxy statements for fiscal years 2002-2006 falsely stated that “the

19
 20 ¹⁶ See *Immune Response*, 347 F. Supp.2d at 1025 (“[W]hether the alleged omissions and
 21 misstatements actually were the cause-in-fact of the [decline in] price of [defendant's] stock
 22 raises an issue of fact and, as such, is a question properly reserved for a motion for summary
 23 judgment or for the trier of fact.”); see also *In re Openwave Sys. Sec. Litig.*, No. 07-1309,
 24 2007 U.S. Dist. LEXIS 80558, at **41-44 (holding that where Openwave had disclosed other
 25 negative news on the same dates as one of the announcements regarding the backdating was
 26 not fatal to plaintiffs' claim since, the issue of whether these disclosures actually caused all or
 27 part of the price drop was a matter left for proof at trial); *In re CMS Energy Sec. Litig.*, No 02-
 28 072004, 2005 Dist. LEXIS 439, at *5 (E.D. Mich. Jan. 7, 2005) (“[T]he court should not
 speculate on what degree of the price decline is attributable to the disclosure of [a particular
 fact].”); *In re Credit Suisse-AOL Sec. Litig.*, 465 F.Supp.2d 34, 55 (D. Mass. 2006)
 (“Whatever the truth of the matter is, isolating the myriad causal factors that affect stock price
 is a factual question that should be decided at trial, with the help of qualified experts. It is not
 an issue appropriate for a motion to dismiss.”).

1 exercise price of the stock options was equal to the price of the stock on the date of the grant.”
 2 ¶ 66, 162. The Complaint further details the specific elements of each of the Company’s
 3 stock option plans detailed in the Proxy Forms. ¶ 49-53.

4 **B. Lead Plaintiff Has Alleged the Link Between the Misrepresentations and**
 5 **Shareholder Votes**

6 Defendants argue that Lead Plaintiff has failed to satisfy the “essential link” element
 7 required to plead a § 14(a) violation conveniently focusing on only one allegation in Lead
 8 Plaintiff’s complaint. Rather than support their argument with facts and case law, Defendants
 9 choose to illustrate how certain directors were still able to exercise stock options, despite
 10 share holder votes. Def. Mem. at 22-23. This has no bearing on how Defendants’
 11 misstatements in their 2002-2006 proxy forms were essential links in the “accomplishment of
 12 the proposed transaction” in the proxy at issue. *Desaigoudar v. Meyercord*, 223 F.3d 1020,
 1022 (9th Cir. 2000).

13 The question is not whether Lead Plaintiff can allege and prove that the false
 14 statements in the proxy led to the vote in question, but rather (i) whether the alleged
 15 misrepresentations were material to the shareholders in deciding to vote; and (ii) whether the
 16 proxy was necessary for the vote in question.¹⁷

17 Defendants do not dispute that the proxies were an essential link to the shareholders’
 18 votes. Lead Plaintiff’s Complaint specifically alleges that in order for the Company’s various
 19 stock option plans or amendments to such plans to have been approved, the board required
 20 shareholder approval. ¶ 49. Where, as here, the board required shareholder approval for
 21 implementation of or an amendment to a stock option plan or similar compensation plan, the
 22 essential link element is established. *See, e.g., Parsons v. Jefferson-Pilot Corp.*, 789 F. Supp.
 23 697 (M.D.N.C. 1992); *Franklin v. Ernst*, 571 F. Supp. 829, 842 (N.D. Ohio 1983) (“In this

24
 25 ¹⁷ *See Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384-85 (1970) (explaining that where
 26 there has been a finding of materiality, a shareholder has made a sufficient showing of causal
 27 relationship between the violation and the injury for which he seeks redress if, as here, he
 28 proves that the proxy solicitation itself, rather than the particular defect in the solicitation
 materials, was an essential link in the accomplishment of the [corporate] transaction).

1 case, the plan, by its terms, required shareholder approval. The solicitation of proxies,
 2 therefore, was ‘an essential link in the accomplishment of the transaction.’ Accordingly, if
 3 the proxy statement contains a material misstatement or omission, the causation requirement
 4 is met.”).

5 The 2003-2006 Proxies were also an essential link to the vote on the election and re-
 6 election of Lu, Wu and Toy.¹⁸ Courts routinely find that the essential link element is met
 7 where, as here, the proxy seeks a vote for the election of directors. *See, Zoran*, 2007 U.S.
 8 Dist. LEXIS 43402, **67-68.

9 There can also be little doubt that the misrepresentations in UTStarcom’s Proxies were
 10 material to shareholders’ voting decisions. The Supreme Court long ago established that a
 11 misrepresentation or omission is material if “there is a substantial likelihood that a reasonable
 12 shareholder would consider it important in deciding how to vote.” *TSC Indus. v. Northway*,
 13 *Inc.*, 426 U.S. 438, 449 (1976); *see also Zoran*, 2007 U.S. Dist. LEXIS 43402, at *63.

14 Applying this test, courts have confirmed that facts regarding the nature, purpose, value and
 15 recipients of stock option grants and past practices are important factors to be considered by
 16 shareholders solicited to vote on an amendment to a stock option plan. *See, e.g., Parson*, 789
 17 F. Supp. at 702 (“If an omissions or misstatement of one of these elements is made, the
 18 omission or misstatement is deemed material as a matter of law.”). Most recently, the court in
 19 *Zoran*, faced with a similar backdating case reiterated that “[h]ad shareholders known that
 20 defendants had not followed the dictates of the plan in the past, this likely would have
 21 changed their votes” regarding their authorization of stock options plans. 2007 U.S. Dist.
 22 LEXIS 43402, at **66-68.

23 Accordingly, Lead Plaintiff has adequately alleged the materiality of Defendants’
 24 misrepresentations regarding how they granted stock options, the terms of option grants to
 25

26 ¹⁸ The 2003 Proxy solicited shareholder votes for the re-election of Lu for a three year term on
 27 UTStarcom’s Board. The 2004 Proxy solicited shareholder votes for the re-election of Toy
 28 and Wu for a three year term on UTStarcom’s Board. The 2006 Proxy solicited shareholder
 votes for the re-election of Lu for a three year term on UTStarcom’s Board.

1 officers and directors and executive compensation. ¶ 8, 49-53, 66, 161-66. Whether the
 2 statements were indeed material is a question of fact for the jury. *Livid Holdings Ltd. c.*
 3 *Salomon Smith Barney*, 416 F.3d 940, 947 (9th Cir. 2005).

4 **C. Lead Plaintiff has Adequately Alleged Defendants' Knowledge and**
 5 **Recklessness With Regard to the Misrepresentations**

6 Defendants contend that Lead Plaintiff has not adequately pled that Defendants acted
 7 negligently. This contention is without merit as Lead Plaintiff has pled particularized facts
 8 establishing Defendants' scienter, as discussed above. This higher standard covers negligence.
McKesson, 126 F.Supp. 2d at 1268 n.10; *Zoran*, 511 F. Supp.2d at 1015.

9 **D. Lead Plaintiff's Claims regarding the 2002-2006 Proxies Are Not Time**
 10 **Barred**

11 Defendants' argument that § 14(a) claims for the admitted misrepresentations
 12 contained in the 2002-2006 Proxies are time barred ignores the fact that Lead Plaintiff alleges
 13 his § 14(a) claim for fraudulent conduct. Section 804 of Sarbanes-Oxley provides for a 5-2
 14 limitation period for any fraud based claim brought under the Exchange Act. By its express
 15 terms, § 804 applies not only to § 10(b) claims, but to claims brought under a number of
 16 statutes including the Exchange Act or the Securities Act. 28 U.S.C. § 1658(b). The sole
 17 limitation is that the claim must be "a private right of action that involves a claim of fraud,
 18 deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning
 19 the securities law." Thus, § 804 clearly applies to any claim sounding in fraud that is brought
 20 under the Exchange Act for contravention of a regulatory requirement concerning the
 21 securities laws.¹⁹

25 ¹⁹ The Ninth Circuit has not yet opined on the issue of whether Sarbanes-Oxley applies to §
 26 14(a) claims. While a few district courts across the country have declined to apply § 804 to §
 27 14(a) claims sounding in negligence, they are inapposite because they did not address the
 28 issue of whether § 804 applies to § 14(a) claims sounding in fraud. *See, e.g., In re Amtel*
Corp. Deriv. Litig., No. 06-4592, 2007 WL 2070299, at *8 (N.D. Cal. July 16, 2007).

1 Lead Plaintiff's § 14(a) claims sounds in fraud, and therefore, § 804 applies.
 2 Consequently, Defendants' argument that Lead Plaintiff's § 14(a) claims with respect to the
 3 2002, 2003 and 2004 Proxies are time barred is mistaken.

4 **VI. LEAD PLAINTIFF HAS STATED A CLAIM FOR CONTROL PERSON**
 5 **LIABILITY PURSUANT TO SECTION 20(a)**

6 Lead Plaintiff has adequately plead primary violations of the securities laws on behalf
 7 of Defendants Lu, Wu, Sophie, Barton and Toy, as control persons. As such, Lead Plaintiff
 8 has adequately stated a claim under Section 20(a). *See In re Ditech Networks, Inc. Derivative*
 9 *Litig.*, No 06-5157, 2007 WL 2070300, at *9 (N.D. Cal. July 16, 2007) (holding that "to state
 10 a claim under Section 20(a), a plaintiff must allege (1) a primary violation of federal securities
 11 law; and (2) that the defendant exercised actual power or control over the primary violator.").
 12 Whether the Individual Defendants actually are "controlling persons" under § 20(a) is a
 13 question for the jury.²⁰

14 **VII. CONCLUSION**

15 For the foregoing reasons, the motion to dismiss should be denied in its entirety.

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Respectfully submitted,

By: _____/s/ _____

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26 ²⁰ *See Howard v. Everex Sys.*, 228 F.3d 1057, 1065 (9th Cir. 2000)(quoting *Kaplan v. Rose*,
 27 49 F.3d 1363, 1382 (9th Cir. 1994) ("Whether [the defendant] is a controlling person is an
 28 intensely factual question, involving scrutiny of the defendant's participation in the day-to-
 day affairs of the corporation and the defendant's power to control corporate actions.").

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